

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, 17th Floor
Sacramento, California 95814

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Regulation File: RH05045983

INITIAL STATEMENT OF REASONS
Life and Annuity Consumer Protection Program Regulations

SPECIFIC PURPOSE OF THE REGULATION

California Insurance Commissioner John Garamendi (the “Commissioner”) proposes to add to California Code of Regulations, Title 10, Chapter 5, Subchapter 9, a new Article 1, sections 2698.23 through 2698.27 entitled “Life and Annuity Consumer Protection Program” regulations. The proposed regulations set forth the method of assessing the fee on life insurance policies and annuity contracts and the application process, reporting requirements and allowable use of funds to be distributed to district attorneys for purposes of enhanced investigation and prosecution of life insurance and annuity financial abuse.

REASONABLE NECESSITY

The Legislature enacted this statute because it found that the incidence of life insurance and annuity financial abuse, particularly against seniors, had increased dramatically over the past few years and additional resources were needed to bolster the ability of both District Attorneys and Department of Insurance investigators to actively and aggressively investigate and prosecute these cases of insurance financial abuse. The life insurance industry agreed to participate in solving this growing problem by supporting an assessment on all new individual life and annuity policies valued over \$15,000 sold on an annual basis to California consumers. The Legislature determined that an annual fee of up to \$1.00 on each policy meeting the criteria would provide a base fund from which to distribute grants to District Attorneys and fund additional investigators and consumer education materials at the Department. The Legislature also determined the process and procedures for distribution of funds to District Attorneys including the application, award, and reporting requirements.

Sections 2698.23 and 2698.23.1 describe the authority and purpose of these regulations and provide definitions for the most frequently used words. Section 2698.24 describes how the fee shall be assessed on life insurance policies and annuity contracts, the method used by the Department to accomplish the assessment, the reporting responsibilities of the insurers and the timeframe for compliance, and the penalties and late fees applicable for late or non-reporting. Section 2698.24.1 explains in detail how to value an annuity for the purposes of this assessment. These sections are reasonably necessary to provide insurers with clear, detailed information and instructions as to how the fee will be assessed and how an annuity should be valued for the purposes of the assessment.

Sections 2698.25 through 2698.25.3 set forth the requirements for the distribution of funds to District Attorneys including the criteria for awarding grants, procedure for funding grants, application procedures, and reporting requirements. These sections are reasonably necessary to

provide clear, detailed information to District Attorneys to enable them to apply for grant funding and to ensure the appropriate use of grant funds under the statutory requirements.

Section 2698.26 and 2698.27 describe the use of unexpended funds and the Commissioner's authority under the statute. These sections are reasonably necessary to inform the grantees of the manner in which they shall handle unexpended funds and the Commissioner's responsibilities to the grantees under this statute and authority to review grantees' records as needed. The specific purpose of each regulation and the rationale for the Insurance Commissioner's determination that each regulation is reasonably necessary to carry out the purpose for which it is proposed are set forth below. Implementation of these regulations is necessary for the efficient administration and enforcement of the Code.

§2698.23 AUTHORITY AND PURPOSE

This section sets forth the authority under which these regulations are promulgated. It also specifies the purpose of the regulations to describe the method of assessing the fee on life insurance policies and annuity contracts, to clarify the application process and reporting requirements for District Attorneys, and to identify the allowable use of grant funds. This section is reasonably necessary to inform affected persons and insurers of the scope and application of the regulations.

§2698.23.1 DEFINITIONS

This section provides definitions to words and terms used throughout the regulations. Although many of the words and terms defined have a generally understood meaning in the insurance industry, definitions of those words and terms are included to avoid any ambiguity or uncertainty in the application of the regulations.

These definitions are reasonably necessary to inform affected persons of the specific applicability and specific meaning of various requirements. However, certain of the definitions are used to encompass concepts that may not be readily apparent from the word or term used. These definitions are discussed below.

"Assessment" is defined in this section to specifically identify the type of assessment being made on insurers. The Department conducts a number of other "assessment" programs thus making it necessary to specifically define the scope of this fee assessment, the type of insurance policies subject to the assessment and the range of application of this assessment to California insurers. The definition is reasonably necessary to clarify that "assessment" as used in the regulations applies only to specific types of insurance policies and specific insurers. This definition is reasonably necessary to clarify and make specific Code Section 10127.17(a).

"Grant funding cycle" is defined as the period of time designated by the Commissioner for a grant cycle. This definition is reasonably necessary to clarify that the length of a grant cycle may vary and will be determined by the Commissioner.

"Life and Annuity Consumer Protection Program (LACPP)" defines the scope of the program funded and administered by the Department. This definition is reasonably necessary to clarify the purpose for which this program is established and for which grants are awarded.

"Life insurance and annuity financial abuse" defines the activities that constitute "life insurance and annuity financial abuse" as, "the sale or attempted sale of any product, including a life insurance policy or annuity product through misrepresentation as to its benefits, terms or

conditions of the policy or product, to a person who will not benefit as represented from the sale because of the cost of twisting or churning, or the unsuitability of the product for the needs and status of the targeted buyer.” This definition also identifies the specific code sections, a violation of which constitutes “life insurance and annuity financial abuse” for the purposes of these regulations. This definition is reasonably necessary to specifically describe the activities and statutory grounds that encompass “life insurance and annuity financial abuse” for the purposes of these regulations and the LACPP.

§2698.24 ASSESSMENT, REPORTING AND PENALTIES

This section identifies the specific type of policies subject to the fee assessment, the beginning date of the assessment, and how frequently the assessment will be made on insurers. It describes the methodology used by the Department to conduct the assessment and the timelines for completion. This section identifies the data upon which the assessment is based as well as the requirement that life insurers communicate their contact information to the Department’s LACPP coordinator regularly. It also informs insurers of the requirements for maintenance of the data. This section notifies insurers as to the penalties and late fees that may be charged for late reporting. This section is reasonably necessary to inform insurers as to the specifics and details of the assessment under this statute.

§2698.24.1 ANNUITY VALUATION

This section defines how an annuity shall be valued for purposes of this statutory fee assessment. Due to the variation in the type of annuity, its value, and other factors such as whether the annuity is fixed or variable, deferred or immediate, single premium or flexible, it is reasonably necessary to specify how an insurer will value an annuity so that it can be determined if an assessment is required and the amount of such an assessment.

§2698.25 ALLOCATION OF FUNDS

This section establishes the amount of funds available for the Department and the amount of funds available for distribution to district attorneys through grants. It also describes the authorized uses of said funds. This section is reasonably necessary to clearly describe the approved use of funds to the Department and to district attorneys and the percent of the total funds accumulated that will be available to each.

§2698.25.1 CRITERIA FOR AWARD OF GRANTS

This section provides notice to grantees of the specific criteria that will be used by the Department to evaluate grant applications from district attorneys so that LACPP funds may be awarded. This section is reasonably necessary to provide district attorney applicants with clear, specific criteria for selection of grant applications for funding.

§2698.25.2 APPLICATION PROCEDURE & REQUIREMENTS

This section describes in detail the required contents of an application for funding from district attorneys. It sets out the distinct parts of the proposal narrative and the budget proposal and the required attachments. This section describes a joint application and its requirements. It also establishes the confidentiality requirements for information submitted to the Department. This section is reasonably necessary to notify affected persons of the specific requirements for submitting an application for funding.

§2698.25.3 DISTRICT ATTORNEY REPORTING

This section provides notice to grantees of the reporting requirement to the Department. It describes the contents of the final Program Report and the final Expenditure Report and establishes their due dates. This section also describes the process to be followed by grantees awarded multi-year grants or applying for grant renewal including when to apply for renewal of the grant and the required documents to be submitted to the Department. This section is reasonably necessary to clearly provide grantees with the requirements for reporting their grant activities to the Department.

§2698.26 UNEXPENDED FUNDS AND GRANT LIQUIDATION

This section establishes the process and time frame for liquidation of any remaining grant funds at the end of the grant funding cycle. It details how funds may be carried over into another funding year. This section is reasonably necessary to inform grantees about how to handle excess grant funds.

§2698.27 COMMISSIONER AUTHORITY

This section provides information about the services the Commissioner may provide to the grantee. It also informs the grantee about how the Commissioner will monitor performance under the grant and how unsatisfactory performance by the grantee will be handled. This section explains how unused funds will be reallocated.

This section explains the Commissioner's right to review, reproduce, monitor and audit the records of the grantee. It describes the grantees duties regarding records management and retention. This section details the Commissioner's rights and the grantee's responsibilities regarding auditing the grant. This section also defines the cause for termination of the grant by the Commissioner or the grantee as well as applicable timelines. This section and subsections are reasonably necessary to interpret, clarify and implement Code Section 10127.17.

ECONOMIC IMPACT ON SMALL BUSINESS

The Commissioner has not identified any economic impact on small business from these regulations. The first portion of the regulations applies solely to life insurers; the remainder of the regulations applies to local district attorneys, neither of which is considered a small business.

IDENTIFICATION OF STUDIES, REPORTS, DOCUMENTS

The Commissioner did not rely upon any technical, theoretical, or empirical studies, reports or documents in proposing the adoption of this regulation.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of these regulations would not mandate the use of specific technologies or equipment.

REASONABLE ALTERNATIVES

The Commissioner has determined that no reasonable alternative exists to carry out the purpose for which the regulations are proposed: implementing section 10127.17 of the Insurance Code. Regarding the determination of which life insurance policies and annuity products should be assessed the fee and the methodology for assessing the fee on annuity products, the Commissioner determined that performance standards were not appropriate. Performance standards were also considered but rejected in light of the fact that the number and speed of prosecutions of life and annuity financial abuse vary greatly due to many factors including location, staffing and case difficulty.

PRENOTICE PUBLIC DISCUSSIONS

The Commissioner did not hold official public discussion on these proposed regulations because they are not complex proposals nor do they include a large number of proposals. However, a number of pre-notice informal discussions were held with life insurers to develop the most appropriate method of assessing the required fee as well as determining how to value an annuity. Informal discussions were also held with representatives of the California District Attorneys Association to identify key areas of concern. Input obtained from these discussions was considered in formulating the proposed regulations.